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GENERAL COMMENTS BY ORR/G/NE ON AID PAPER:  
"Implications of U.K. Withdrawal from South Arabia"

1. A discrepancy on the size and origin of national product recurs throughout the AID and CIA papers. The AID estimates are based on information not available when the CIA analysis was written. We have revised our data, based partially on the new information, and we have attached a detailed explanation of the revision for the information of AID and other interested parties. No useful purpose is served by minute scrutiny of figures that in any case are highly speculative and are useful only to convey impressions of magnitude. The primary difference, however, is that we estimate a somewhat higher present GNP for Aden State, because of higher estimates for trade and for services, as well as a larger base sector.

2. The detailed commentary on AID's paper is provided as a separate document. Several generalizations, however, can be made:

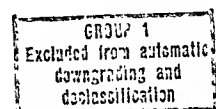
a. The AID paper shows a consistent bias toward the most favorable possible interpretation of future events. While using factual data provided in our paper, it omits the analytical commentary -- commentary that stressed our conviction that the economic effects being outlined were the theoretically feasible optimum and were unlikely to be achieved or even approached in view of the political situation.

b. The AID paper understates the seriousness of the economic dislocation that is implied by its own data. The paper states that an immediate drop of 20% in the GNP of Aden "need not be critical in an area already artificially built up beyond the capabilities of its resource base." Elsewhere, the paper refers to this change as "some downward drift of economic activity." A sudden loss of 20% of national income is a very serious matter in any situation. We fail to see that the source of income, whether it is regarded as "artificial" or not, is pertinent to the effect of the loss of income on the population. In this connection, international comparisons of GNP similarly are irrelevant.

c. Part of AID's optimistic view of the post-independence Aden economy seems to be based on the assumption that as yet uncommitted support from several sources (the U.K., Saudi Arabia, Kuwait, and the U.N.) will materialize. Perhaps some of this support will be forthcoming, but this hope should not obscure the size of the problem being considered.

d. AID concludes its cover memo with the statement, "We do not think that assistance from AID is necessary for South Arabia to develop its economic potential consistent with its underlying resource base." Aden's economic resource base -- the infrastructure of the port and refinery, the location, and the trained labor force -- is not so limited as AID implies,

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and, given real political stability, Aden might well be able to return to its present level of economic activity with outside assistance. In fact, however, the future of the area depends on stability and tranquility, and the role of possible U.S. economic assistance should be judged against its potential impact on this crucial question.

e. Although we differ with AID's arguments, we can reach the same conclusion for different reasons. Although economic difficulties undoubtedly would aggravate politically-inspired unrest and turmoil, there is no reason to believe that even prosperity and plenty would negate or materially diminish the likely political troubles. As we stated in our EM, South Arabia's economic future depends first on the political and security situation in Aden and second on continued outside support. Tranquility in Aden cannot be insured solely by maintaining economic prosperity through development assistance. A struggle for political power is likely to occur whatever the economic situation.

f. Considerations of assistance to South Arabia also should take into account two additional factors: (1) Given the probability of political disturbances, the economic strains are likely to be so severe that any aid program would have to be undertaken on a very large scale to have any prospect of negating the effects of British withdrawal. (2) Whatever post-independence government(s) appear will be targets for many opposing forces and may be very short-lived; economic aid will associate the donors with those regimes and bring the donors under determined attack from many sides.

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ESTIMATED NATIONAL INCOME FIGURES -- ADEN STATE

CIA/ORR would estimate the GNP of Aden in 1966 roughly as follows:

<u>Source</u>	<u>Amount</u>	<u>Percent of Total</u>
Military installations (1)	\$35 million	20%
Refinery	10	6
Port and shipping	12	7
Bunkering and petroleum distribution	5	3
Other industry	8	5
Trade and tourism (2)	36	20
Government	40	23
Construction, transportation, rent, emigrant remittances, etc.	14	8
Services (3)	<u>15</u>	<u>8</u>
Totals	\$175 million	100%

The above should be understood clearly to be estimates. The numbers do not imply great precision; those that appear to make fine distinctions are handled in this manner to give a rounded and generalized-looking total. Those estimates that differ significantly from Consulate and/or AID estimates are explained below.

(1) Military installations -- The \$24 million spent in Aden by British servicemen and their families is not devoted entirely to purchase of goods. It is reasonable to assume that about half is spent for services -- domestic servants, tailoring, hairdressers, waiters in restaurants, etc., that should be tabulated at their full price in calculating GNP. Some further small share is spent for local goods, which also represents an addition to GNP. An outflow of associated profits remitted abroad is allowed for by reducing the GNP derived from sales to base authorities. The outflow of profits associated with imported goods is reflected in the figure for GNP derived from that source. The military installation component of GNP then would break down approximately as follows:

	<u>Total Expenditure</u>	<u>Contribution to GNP</u>
Spent by servicemen and families		
For services	\$12 million	\$12 million
For local goods	2	2
For imported goods	10	2
Spent by base authorities		
For salaries to local personnel	8	8
For fuel, utilities & local goods	9	7
For capital investment	<u>4</u>	<u>4</u>
Totals	\$45 million	\$35 million

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(2) Trade and tourism -- Consulate estimates of September 1966 have been adjusted on the basis of information in the Consulate's A-109 of 1 Jan 67:

Non-petroleum imports	\$115 million	
Less sales to servicemen & base	10	
Net to avoid double-counting base sector	\$105 million @25% profit	\$26 million
Non-petroleum exports	75 million @12% profit	9 million
Transit trade	50 million @20% profit	10 million
Total profit on foreign trade		\$45 million
Less profits remitted abroad (\$45 million @ 20%)		10 million
GNP stemming from foreign trade		\$35 million
Tourism (net of profits remitted abroad)		1 million
<u>Total GNP from trade and tourism</u>		<u>\$36 million</u>

(3) Services -- This figure is substantially higher than Consulate and AID estimates, even after reducing likely services income by the amount estimated to be derived from British servicemen and their families. Available employment statistics show about 20,000 persons in Aden engaged in services other than those included in one of the specified sectors -- almost one-third of the employed labor force. About 42,000 persons are shown to be employed in petroleum activities, industry, construction, trade, the port, the base, and government -- activities accounting for about \$110 million in GNP (using for this GNP total only \$8 million for base salaries and excluding foreign subsidies to the government). Assuming that a "services" employee contributes only about  $\frac{1}{2}$  as much to GNP as a "production" worker, 20,000 persons could be expected to generate GNP of \$25-30 million. Deducting the \$12 million estimated to be flowing from British military personnel leaves about \$13-18 million in other GNP from services; \$15 million has been used as a reasonable estimate for our purposes.

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DETAILED COMMENTARY ON AID PAPER

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1, 2

The assumptions and conclusions in this paragraph seem far too optimistic.

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Specifically, withdrawal of the base in Aden will not cause only a simple, one-shot loss of \$25 (we say \$35) million in GNP. Some \$20 million of this is paid in salaries to persons who immediately spend most of it on the local economy and thereby contribute some obviously large amount to the GNP generated in other sectors. Furthermore, the security function performed by British troops has a tremendous, though unmeasurable, value on the earning ability of the entire State of Aden. As mentioned above, and as detailed in our EM, 40% of Aden's aggregate income stems from these sources that will be jeopardized if the security system breaks down.

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We agree with AID that some emigration is likely that will help to cushion the impact on per capita income averages. However, this simple statement also is misleading because it is incomplete.

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As we also pointed out in \_\_\_\_\_ our paper, if the post-independence situation is characterized by violence and chaos, the income effects soon will be aggravated, rather than softened, by the exodus of skilled foreign manpower -- i.e., by the removal of those persons best equipped to keep the economy running with any semblance of efficiency and any chance of profitability.

The statement about adjusting economic activity to conform to the "resource base" also may be misleading. If resource base is taken to include geographical location, availability of manpower, etc., as well as physical assets such as the port installations and refinery, Aden does have economic wherewithall that is theoretically sufficient to permit renewed growth after an initial shock created by the base closure. (See page 18 of our paper.) The problem, again, is the probable political situation and its likely impact on economic activity. By minimizing Aden's existing assets and opting for dependence on a "resource base" AID begs the question -- in fact, the future of the area depends on stability and tranquility, and the role of possible U.S. economic assistance should be judged against its potential impact on this crucial question.

- 2, partial para. "British military installations which receive about \$45 million a year" is factually inaccurate. That is the amount they spend on the local market in Aden.
- 2, 2 Attempts to find oil have little or no relation to this paragraph, which is concerned with Aden. The oil explorations have taken place far to the east.
- 2, 3 The port at Aden normally handles about 500 ships a month. During the unsettled months of late 1965, however, traffic dropped off about 30%.
- 2, 4 The figure for British assistance in FY 1965 disagrees with anything we have. The Consulate, using published budget figures, set the total at about \$28 million in FY 65. The

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[REDACTED] the actual for FY 65/66 could be estimated to be about \$45 million. And, if AID is referring to FY 65/66, then the figure for development and welfare expenditure should be \$9.52 million. The \$7 million figure cited by AID refers to FY 64/65.

3, partial para. "may continue the fairly modest amounts of the past, although probably on a declining scale" is not very enlightening. As of November 1966, the Consulate reported that development funds from the UK for all of South Arabia would fall from \$6.7 million last year to \$6.2 million in the current year and \$3.9 million in FY 67/68.

3, 1 Aden itself could remain economically viable after the British leave, if the security situation permits, but would not...

The U.K. finances less than 10 percent of the revenue of the State of Aden but furnishes over 75 percent of the Federation revenue and over 60 percent of the income of the non-federated states.

The U.K. pledge of \$27 million annually to the Federation Army until 1971 covers the present total cost of that organization and the Federal National Guard it will absorb, but it is \$4 million short of the present total cost of security forces (including police) in the Federation and \$12 million less than the anticipated costs of Federation security in the first year after independence. The

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[REDACTED] The non-federated eastern states may be able to obtain some assistance from Saudi Arabia or other rich neighbors but probably cannot fully replace the subsidies of over \$3 million annually that the British have threatened to cut off if they remain outside the SAF.

3, 2 The GNP of Aden itself amounts to about \$175 million annually, or approximately \$700 per inhabitant. In the

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remainder of the area, aggregate income probably totals some \$85 million, or about \$130 per capita. (NOTE: the latter figure includes the non-federated states.) Although per capita incomes in Aden appear to compare favorably with similar figures for nearby countries, neither the price structure nor the nature of the economy provides any basis for judging relative real incomes. And, in any case, the South Arabians will note only what happens to their own incomes, not how they may stand relative to other Arabs.

3, 3

The U.K. military complex alone contributed about 20% of the GNP of Aden in 1966 and had little if any influence on economic activity in the rest of South Arabia. Withdrawal of the base will remove this source of income and, even if accompanied by some emigration, will cause an immediate decline of 10-15 percent in per capita income. British subsidies, either to Aden or to the Federation but expended in Aden, probably account for another 10 per cent of total income. As they decline, Adeni earnings will be affected further. And, if the security situation deteriorates, Aden could begin to lose the 40 percent of aggregate income that comes from refinery, port, and retail activities. The remaining states in the Federation have been promised no assistance from the British in the post-independence period, aside from the U.K. contribution for the Federal Army. Saudi Arabia has promised to provide a small development fund that probably would be spent in the outlying areas of the SAF. The \$2 million annually that might come from this source, however, is less than the one-year decline in British assistance. Furthermore, Saudi Arabia may be slow to actually provide this money until the nature of the eventual SAF government is more nearly discernable. The Federation has not yet found a substitute source for the other subsidies presently provided by the British. The non-federated states similarly are without sponsors, and their situation is aggravated by the recent departure of oil exploration teams that had been spending \$4 million annually in the eastern area.

4, 1

NOTE: The amounts designated in Consulate (it is not an Embassy) reporting for the Protectorates are not solely for the non-federated states. The term refers to all the states of the former Protectorates -- that is, all of South Arabia except Aden.

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from Saudi Arabia for development, either the shortfall could be reduced or development could be maintained at roughly the reduced level anticipated for 1967. Withdrawal of British staff will reduce government expenditures but will deprive the governing entities of most of their most valuable personnel.

Local government revenues will, of course, suffer adverse effects from the withdrawal of British military installations, since tax revenues are generated primarily in Aden, where economic activity is expected to fall off sharply.

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6, 1

Assuming a peaceful transition when the military forces are withdrawn and a continued inflow of foreign subsidies or aid funds totalling \$33 million, South Arabia stands to lose about \$49 million in GNP -- \$35 million derived from the bases, and a \$14 million reduction in subsidies. Aden would lose \$40 million, including an estimated \$5 million in aid to the Federation that flows into Aden, the balance of the Federation would lose \$5 million, and the non-federated states would lose \$4 million. Thus the GNP of Aden would drop from about \$175 million to about \$135 million (down about 23 percent), and the aggregate income of the rest of South Arabia would fall from about \$85 million to about \$75 million (down about 10 percent). The blow to Aden may be cushioned by some reduction in profits remitted abroad. These effects are, however, only the minimum initial drop that could be expected, and the withdrawal of such large sums from the spending stream probably would create further large losses in a short period of time. Aden will be particularly hard hit by the sudden loss of perhaps 20,000 to 30,000 jobs -- almost half the total employment opportunities now extant. Massive unemployment undoubtedly will aggravate the existing uneasy political situation, and renewed labor difficulties or continued and accelerated outbreaks of terrorism could cause loss of a major share of the income Aden earns from its port, bunkering, tourist, and retailing activities. Outside Aden, the economic effects will be determined by the fate and actions of the nascent Federation government and by the success of the non-federated states in attracting outside assistance.

6, 2

In sum, the withdrawal of British forces from Aden, and the anticipated reduction of British assistance to the area, will cause a sharp and painful drop in economic activity that will be particularly severe in an area that depends so greatly on foreign-oriented transactions and has relatively little of the traditional, subsistence-type activity that could cushion the impact of the sudden change. The area has resources (location, infrastructure in the Aden area, port facilities, the oil refinery, trained manpower, etc.) that could permit it to return to recent levels of prosperity after a relatively brief period of recession, but this will be possible only if that interim period is one of internal cooperation and relative tranquility. If the port and shops once lose their customers to competing ports and traders in the area, regaining preeminence will be very difficult.

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- 1, 1 See attached comments on aggregate income. The value added concept measures that portion (\$35 million) of the total \$45 million base expenditure that accrues to residents of Aden as wages, profits, rents or added investment. The remaining \$10 million is not diverted into other sectors. Rather, it is the import price or profits remitted abroad associated with goods purchased by servicemen or base authorities.
- 2, 1 See general comment on comparing per capita income figures.
- 2, 3 The 30-35,000 figure on jobs dependent on the base probably is a bit high -- 20,000 to 30,000 probably is closer to the mark. Furthermore, this includes merchants, servants, and local contractors as well as laborers.
- 3, 3 Assuming complete withdrawal of the \$35 million presently derived from the military bases and a reduction in government foreign income of only \$5 million in Aden because of reduced subsidies and aid, and placing the best possible interpretation on other factors, the GNP of Aden could total about \$160 million in 1970. The crucial assumptions for such a relatively favorable prognosis are continuation of refinery, port, tourist, and trade activities at approximately the current level (which depends on maintenance of effective security arrangements for foreign ships and persons) and a large shift in ownership of such facilities to Adeni hands, reducing the outflow of profits by \$25 million. Under these assumptions, the changes between 1966 and 1970 might be about as follows: (Data in current million U.S. dollars.)

	<u>1966</u>	<u>1970</u>	<u>Comment</u>
Military installations	35	0	
Refinery	10	20	Assumes expanded output and about 50% local ownership
Port and shipping	12	15	Assumes increased local ownership; little increase in activity

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	<u>1966</u>	<u>1970</u>	<u>Comment</u>
Bunkering and oil distribution	5	5	
Retail and wholesale trade	35	45	Assumes no decrease in activity, large increase in local ownership
Tourism, remittances	5	5	
Government	40	35	Assumes subsidies will decrease only \$5 million
Construction, transport, services	25	25	
Other industry	<u>8</u>	<u>10</u>	
Total	175	160	

Page & Paragraph With reference to specific AID figures: Higher volumes of bunkering, shipping, and other port activities apparently are ruled out by the Consulates statement (A-194, 29 May 1966), "the managers of the bunkering and shipping companies here are universally agreed that this [increased shipping and bunkering activity] is unlikely and some even project a slight reduction..." In practice, earnings from the port, shipping, and bunkering may be very seriously affected if the withdrawal of U.K. military installations results in a deterioration of governmental ability to maintain law and order. Remittances from abroad are likely to fall, if anything, since large numbers of South Arabians recently have been returning to their homes as nationalist sentiment has grown in their countries of temporary residence. Aden's government budget does not depend significantly on British subsidies, but the government sector of GNP contains a large portion of SAF income, which probably will decline as U.K. subsidies are cut.

4, 3 Assuming that the decline in foreign subsidies is \$14 million annually and that \$5 million is in Aden, we would project the "GNP" of the rest of South Arabia in 1970 roughly as follows: (Data in current million U.S. dollars.)

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	<u>1966</u>	<u>1970</u>	<u>Comments</u>
Local government	30	23	\$9 million loss in foreign subsidies and \$2 million rise in local income
Agriculture & fishing	20	20	
Arms smuggling, other services	15	15)	If anything, these are likely to decline
Emigrant receipts	10	10)	
Petroleum & industry	5	2	Petroleum income to drop \$4 million other industry may increase slightly
Other	<u>5</u>	<u>5</u>	
Total	85	75	

Page & Paragraph If the \$6 million annual development aid that has been postulated from the U.K. and Saudi Arabia does not materialize, the 1970 figure would be on the order of \$70 million. And, in the area outside Aden, the population is likely to increase, rather than decrease, so that the per capita decline will be somewhat larger than the decline in aggregate income. AID's projected increase in income from the petroleum industry is unrealistic -- exploration ceased in 1966.

5, 1

Our projections suggest a loss to the area as a whole of about \$50 million, offset by a \$25 million increase in retained profits because of increased local ownership. Any difference between the postulated inflow of foreign aid (\$33 million annually) and the amount actually received, or between the projected and actual trend of profit remittances abroad, would affect the results substantially. Similarly, political disturbances that depressed business activity and interfered with profits would involve large losses to the economy.

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